



INSPECTOR GENERAL REPORT

2005-01-0043

October 27, 2005

INDOT CHANGE-ORDERS

Inspector General David O. Thomas reports to Governor Mitchell E. Daniels, Jr., the following report after an investigation by Special Agents Alan McElroy and Troy Stanton:

The issue is how to prevent future excessive change-orders within Indiana Department of Transportation (INDOT) contracts. This report was prepared with the assistance of INDOT Commissioner Tom Sharp, General Counsel Mark Ahern and INDOT Investigator Jerry Grant.

INDOT is charged with building, maintaining and operating state roads, interstates and U.S. routes within Indiana's borders. Road projects are funded by a combination of federal highway funds allocated to INDOT and state appropriations to INDOT from the dedicated State Highway Fund.¹

In the past year of 2004, there were 499 road projects awarded to contractors by INDOT.² The original value of these contracts was \$848 million.³ INDOT reports that at least 1,750 change-orders were processed in conjunction with these 499 highway construction contracts. In aggregate, the 1,750 change-

¹ I.C. 8-23-9-54.

² This information was obtained from INDOT investigator Jerry Grant.

³ *Id.*

orders increased the cost of the 499 highway construction contracts by over \$68 million.⁴

A “change-order” (also known as an “advice of change”) is a change in the original construction contract between INDOT and the private contractor that results in an increase in the cost of the contract. It is a procedure to fairly compensate a contractor when there is an unexpected event in the performance of the contract. The contractor requests a change-order by filing with the INDOT Project Engineer a written request for the additional payment. The INDOT Engineer then approves or denies the extra money, subject to the review of an INDOT Area Engineer.

Two issues arise: (1) are 1,750 change-orders necessary in 499 contracts, and (2) is it appropriate to spend an additional \$68 million in federal and state funds on change-orders.

There is no doubt that the change-order process is necessary in the construction business. However, the current change-order process has a negative impact in at least three (3) areas beyond the appearance of monetary waste.

First, the process violates rules of procurement. Procurement rules control how the State purchases items. When items are purchased through the current change-order process, the rules required by the state for competitive bidding are bypassed. This results in the purchase of items at inflated prices.

Second, the process creates an incentive for contractors to artificially deflate project cost estimates in order to be awarded INDOT construction projects, only to reap inflated profits through the use of excessive change-orders.

⁴ *Id.*

All but one contractor loses the chance to perform the contract and make his or her profit. When change-orders are abused, it may be that a losing contractor could have done the job at a lower rate than the winning contractor who is later allowed to manipulate a change-order process to inflate the contract revenue.

Third, the ability of INDOT to employ adequate financial controls is impaired. A process that allows an INDOT Field Engineer to significantly alter the terms of a contract circumvents the financial oversight process whereby the purchasing of equipment is scrutinized.

I.

Our investigation revealed an initial concern as to the nature of what was being purchased through the change-order process. To illustrate the abuse, we focused on change-order purchases for field office improvements, which are contrary to the typical process of paying for unanticipated construction project materials. Field office improvements can be anticipated prior to the original contract, contrary to the spirit of the change-order process. Accordingly, it is fundamental that the state's financing of a field office should be at the front end of a construction project, rather than through change-order improvements as were done here.

Specifically, we addressed change-order purchases for a house that was used by INDOT employees as a field office on a 2004 construction project in the city of Ellettsville, Indiana.⁵ This is within the INDOT Seymour Construction

⁵ We also investigated a second house in Lawrenceburg where \$119,000 in remodeling costs were added to the original purchase price of \$124,715. A third concern was a contract related to the Ellettsville project where there were change-orders totaling \$2.1 million.

District.⁶ The house was purchased with state money for \$83,000 dollars. Our investigation shows that four change orders were submitted and approved for improvements to this house, for a total of \$51,661.85 in additional state and federal money. The original value of this particular construction contract was \$8.75 million.

A field office is necessary for most construction projects. It is a place where the INDOT Project Engineer and his or her inspectors may process and secure their paperwork and equipment for the project they are inspecting. A field office has taken various forms in the history of INDOT, sometimes being a leased mobile home trailer, or as here, a house that is purchased for use during the project.

The questionable change-orders were brought to our attention on January 18, 2005 by INDOT Investigator Jerry Grant. An Inspector General investigation commenced. Numerous interviews were conducted. Multiple trips to the field office were made and project documents were reviewed.

The investigation showed that the INDOT Project and Area Engineers approved the change-orders, and likewise, the contractor to the project was involved in the change-order transactions. We concluded that the purchase of the following items through change-orders was unnecessary for the limited purpose the field office house was to provide.

A.

Lumber and supplies for a new deck which were installed on the back of the field office.

⁶ There are six (6) construction districts within INDOT.

B.

Remodeling done on the exterior and interior of the house.

C.

Landscaping purchased for the field office.

D.

The installation of a new heating and forced air conditioning unit.

E.

Dry-walling the basement.

F.

Lowering the ceiling of the utility room.

G.

Installing aluminum siding on the exterior of the house and painting the foundational blocks.

These first seven improvements cost the State an additional \$19,950 beyond the original contract through the change-order process.

H.

We also discovered that a lawnmower and snowblade were purchased through the change-order process for the price of \$4,647, even though INDOT has internal equipment for both needs. We also recovered invoices where maintenance contractors were paid for mowing the grass and snow removal.

I.

A twenty-five cubic foot refrigerator and electric range were purchased for \$1,413.

J.

An insulated, raised paneled automatic garage door was also installed for another \$1,461, again through the change-order process.

K.

Ten mobile radios were also purchased by the contractor through the change-order process in the amount of \$19,750.

L.

We also found that the invoice amounts submitted by and paid to the contractor for the change-orders sometimes exceeded the change-order request.

Change-order documentation requires the contractor to state a reason for the change-order. Often the reason given here was in general terms, such as “administrative costs.” Often the attached invoice did not describe the work to be performed or why the change was unanticipated.

In all the interviews and personal observations at the scene, no plausible reason was given as to why these purchases were unanticipated and needed to be processed with state and federal money through the change-order process.

We also learned that INDOT considered donating this house to the city of Ellettsville after the project, which would have enhanced the loss to the State.⁷

II.

We further discovered that a contractor on the Ellettsville project performed private contractual work for the INDOT Project Supervisor’s father-in-

⁷ INDOT Investigator Jerry Grant.

law who lived in the area. Although it was alleged that payment was given for the service, proper documentation for the service was not produced. At a minimum, this circumstance gives the appearance of impropriety, especially when viewed together with the simultaneous abuses of the change-order process in the same construction project.

III.

Our investigation progressed on April 13, 2005, when Inspector General Investigators met with an INDOT Project Engineer who wished to make an anonymous report on the abuse of the change-order process. The engineer stated that in decades of service, the engineer had only sought five change-orders. The engineer stated that INDOT policy allows a change-order for \$20,000, and that there may be multiple change-orders each day as long as each does not exceed \$20,000. The engineer also advised us that the Area Engineer may authorize up to \$100,000 per change-order, and the District Director of INDOT could authorize up to a one million dollar change-order.

This engineer stated a further concern that project engineers and contractors often work in the same geographic area year after year. This allows project supervisors and contractors to develop close relationships. The engineer further reported that sometimes a contractor and project engineer will meet prior to the bidding of a contract and drive the proposed work area, discussing what items might be changed from the contract which has not yet been bid. This further illustrates the collusion that may result.

IV.

This contract involved 80% federal money and 20% Indiana money. On March 22, 2005, Inspector General Investigators met in Gary, Indiana, with federal agents regarding these abuses. The federal agents declined prosecuting these offenses.

Some may ask why these facts do not warrant a state criminal prosecution. There are two hurdles. First, though the abuse may be great, we could find no personal gain which could be proved beyond a reasonable doubt. The improvements stayed with the field office. Second, there is no specific law or policy that is violated. It is this latter condition which we address in our conclusion with the hopes that new policies or laws imposed would enable a criminal prosecution for future similar conduct. Finally, the two INDOT project supervisors who permitted these actions have been fired by INDOT.

V.

Based upon our investigation, we make the following recommendations:

Recommendation 1: Better controls on the change-order process be implemented, so as not to circumvent procurement, contracting or budget rules. An experienced engineer outside the district should approve the change-order. This may be done by appointing a designated engineer at the central office in Indianapolis to approve the changes.

Recommendation 2: Documented information needs to be generated to justify the change order. This should include at a minimum: (A) the specific work to be performed, (B) the need for the work and (C) why the change was

unanticipated. This document also needs to be (D) signed and approved by the INDOT field engineer, contractor and central INDOT authority. An (E) invoice also needs to be attached to the change-order, and the amounts on each need to match.

Recommendation 3: A rule or agency policy be imposed that prohibits any private work by a contractor working on an INDOT project for the project engineer or family members.

Recommendation 4: The Project Supervisor have no contact with the contractor prior to the completion of the job bidding process, with the penalty to at least include the exclusion of the contractor from the project.

Recommendation 5: Subject to the approval of the State Board of Accounts, the creation and maintenance of a written inventory by the INDOT Project Engineer logging all purchases during the course of the project, with the inventory being filed with the Area Engineer. The purchasing of equipment or items unrelated to construction materials (including equipment and field office improvements) should be strictly scrutinized, and detailed reasons why these items could not have been anticipated in the original contract should be articulated on this written inventory. Such items should also be receipted to the INDOT Area Engineer at the end of the contract, and future use and possession should also be articulated on a written inventory.

For enforcement purposes, these recommendations should be memorialized through: (1) promulgation of INDOT administrative rules, (2) Executive Order, or (3) legislation should the Legislature see fit. These options would provide the requisite foundation for the prosecution of criminal official

misconduct⁸ and the employee's removal from state employment and profit⁹ should similar conduct occur in the future.

Recommendation 6: INDOT consider returning to the policy of leasing mobile homes for field offices as opposed to purchasing real property. Both convenience and the opportunity for abuse would be greatly diminished, especially when maintenance, yard work, insurance, and utility expenses are greater with a purchased home.

Recommendation 7: If not already accomplished, INDOT seize and inventory the house and other purchases in order to avoid further financial loss to INDOT and the State of Indiana, and report these results to the Inspector General's office in writing within 30 days in order for this office to evaluate whether forfeiture action is necessary to return these items to INDOT and state control.

Respectfully submitted this 27th day of October, 2005.


David O. Thomas, Inspector General

⁸ I.C. 35-44-1-2.

⁹ I.C. 35-50-5-1.1.